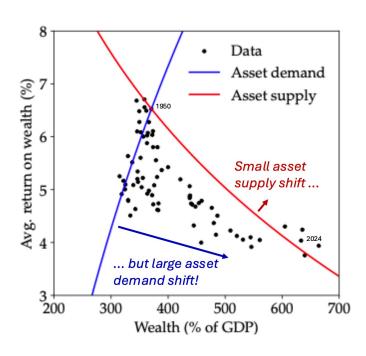


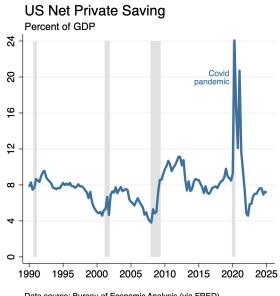
## The path of US interest rates framed as a "race" between asset supply and asset demand



- AMRS provide a rich and rigorous formalization of the oft-invoked "loanable funds" framework
- The relative strength of each side determines the path of rates and the sustainability of current fiscal policy
- Over the last 75 years, asset demand has "won," with the interest rate falling as wealth has risen (graph)

# Key contribution: attention to asset demand (particularly going forward)

- AMRS show that it is essential to focus on how population aging shapes asset demand—not just on supply, as in much analysis of fiscal sustainability
- The shift in demand may have been obscured by the lack of rise in US saving out of income (graph), but AMRS show that an upward revaluation of capital has helped satisfy the higher demand for assets



Data source: Bureau of Economic Analysis (via FRED). Shaded areas correspond to recessions. Last data point: 2025:Q2.

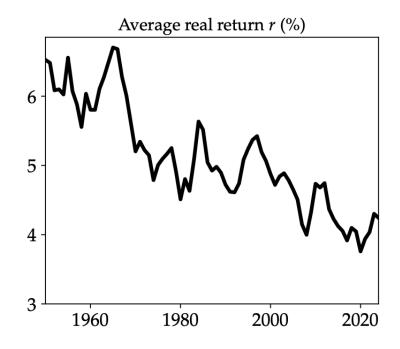
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### Global relevance and striking findings for the United States

- Usefulness beyond the United States:
  - Offers a plausible explanation for why Japan has been able to sustain high government debt with low interest rates
  - The many aging countries of the world might benefit from this sort of analysis
- Headline results:
  - Baseline specification shows that US debt might be able to rise to 250 percent without triggering sharply higher interest rates
  - Suggests fiscal consolidation *might* not be urgent—the US *might* potentially wait decades!

## Before embracing the striking results, let's revisit interest rates in the model

- Interest rates are up from recent lows, but still well below historical norms (graph)
- That low level is a good starting point—but going forward, a key factor will be the debt sensitivity of interest rates (DSIR)
  - DSIR: how many basis points the Treasury interest rate increases for every additional percentage point of D/Y



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### At 0.5bps, the baseline AMRS DSIR is well below most of the literature

#### Review of DSIR Estimates from <u>Gust</u> and <u>Skaperdas</u> (2024)\*

Source	Estimation Period	Effect of 1 pct. pt. increase in debt/GDP (basis points)
Engen and Hubbard (2004)	1976-2003	3 bps
Gale and Orszag (2004)	1976-2004	4-6 bps
Kinoshita (2006)	1971-2004, international data	4-5 bps
Laubach (2009)	1976-2006	3-4 bps
Chadha et al. (2013)	1986-2008	2 bps
Gamber and Seliski (2019)	1976-2017	2-3 bps
Coenen et al. (2012)	N/A	1 bp
Mian et al. (2022)	N/A	1-2 bps
Li and Wei (2013)*	1994-2007	6 bps

<sup>\*</sup>Papers written more recently include <u>Neveu and</u>
<u>Shafer</u> (2024, DSIR = 2 bps) and <u>Plante, Richter and</u>
<u>Zubairy</u> (2025, DSIR = 2.5bps)

- Budget outcomes would be much worse with a higher DSIR
- If debt rises from 100% to 200% of GDP:
  - AMRS baseline => rates rise just 0.5pp
  - Central literature estimates => rates rise 2-3pp
  - An additional 2pp rise increases debt service by another 4% of GDP—requiring either faster debt growth or (if done today) a \$1.2T/year additional fiscal adjustment
- AMRS model a higher DSIR scenario, but don't fully trace out the impact on long-term sustainability

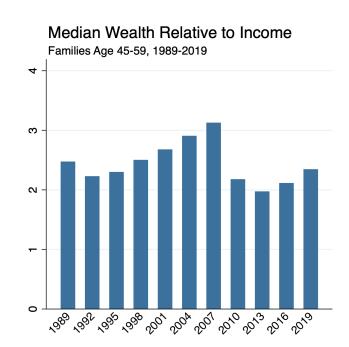
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#### Other risks are also likely understated

- The robustness checks don't examine the potential for:
  - Foreign demand for US assets to weaken ("past is not prologue")
  - Some upside risks to desired government spending—for example, the continuation of rising health care costs per person, or the emergence of other pressures from an aging population such as more demand for government-supported long-term care
  - Fiscal crises triggered by "flow" events even if "stocks" are in balance—for example, "failed" auctions, political brinkmanship, or a "basis-trade" crisis
- Fiscal policymakers should recognize that the welfare costs are asymmetric—a fiscal crisis is far worse than acting "too soon"

## Fiscal consolidation options through the lens of asset demand and supply

- A key result in the paper—raising taxes will reduce wealth and thus asset demand, muting the benefits for interest rates
- Also find the type of tax increase matters; could ask the same about different spending cuts given mounting evidence that some government spending is investment
- I'm less sure that cutting Social Security would raise asset demand—people didn't appear to respond to declining private DB pension coverage by raising their assets in the 1990s, 2000s, 2010s (graph)



Data source: Survey of Consumer Finances and author's calculations. Wealth excludes defined-benefit pensions and Social Security.

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#### In sum

- People should read this paper!
  - It highlights a compelling framework for thinking about interest rates and other macro outcomes in the long run
  - The analysis materially enriches the conversation around US fiscal sustainability and could be applied to any aging economy
- I would love to see more work incorporating some of the considerations I have flagged